Ceylon Ceramics Corporation – 2016

The audit of financial statements of the Ceylon Ceramics Corporation for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016 and the comprehensive income statement, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 29 of the State Industrial Corporations Act, No. 49 of 1957. My comments and observations which I consider should be published with the Annual Report of the Corporation in terms of Section 14(2)(c) of the Finance Act, appear in this report.

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI 1000 – 1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

1.4 Basis for Adverse Opinion

Had the matters described in paragraph 2.2 of this report been adjusted, many elements in the accompanying financial statements would have been materially affected.

2. Financial Statements

2.1 Adverse Opinion

In my opinion, because of the significance of the matters described in paragraph 2.2 of this report, the financial statements do not give a true and fair view of the financial position of the Ceylon Ceramics Corporation as at 31 December 2016 and its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Going Concern of the Corporation

A negative net assets position of Rs.535,643,537 and Rs.525,639,091 had existed in the Corporation as at the end of the years 2015 and 2016 respectively and the total assets to total liabilities ratio of the Corporation for the said years was 1: 5.60 and 1: 5.04 respectively, thus indicating the problems in the working capital. The permanent staff of the Corporation was limited to 39 employees by the year under review and 04 out of 09 factories belonging to the Corporation had been closed down due to the past war situation and lack of raw materials. The Board of Directors had been removed in the year 2010 and a Competent Authority had been appointed for leasing out the factories of the Corporation to suitable investors and to expedite the restructuring process and these matters had adversely affected the going concern of the Corporation.

2.2.2 Accounting Policies

In terms of Paragraph 55 of Sri Lanka Accounting Standard 16, depreciation of an asset begins when it is available for use. However, contrary to that, it had been disclosed under Accounting Policy 2 that depreciation is not carried out in the year of purchase of an asset by the Corporation and that depreciation is carried out in the year in which the asset is disposed of. Accordingly, assets totalling Rs.678,820 purchased in the year under review had not been depreciated.

2.2.3 Sri Lanka Accounting Standards

Non-compliances with the following Sri Lanka Accounting Standards were observed.

(a) Sri Lanka Accounting Standard 02

(i) In terms of paragraph 36(a) of the Standard, the Accounting Policy adopted in measuring inventories had not been disclosed in the financial statements.

(ii) In terms of paragraph 36 (e) of the Standard, write-down of inventories should be disclosed in the financial statements. However, necessary disclosures had not been made in the financial statements on write-down of inventories of 02 factories totalling Rs.1,750,649 as at 31 December 2016.

(b) Sri Lanka Accounting Standard 16

Three motor vehicles costing Rs.4,378,333 had been fully depreciated as the useful life of non-current assets had not been reviewed annually. However, they had still been in use. As such, action had not been taken to revise the estimated error in terms of Sri Lanka Accounting Standard 08.

2.2.4 Accounting Deficiencies

The following observations are made.

(a) The sum totalling Rs.1,000,000 received from the Ministry of Public Enterprise Development in the years 2011 and 2012 for production activities of 02 factories had been credited to the Reserve Account of the Ministry instead of crediting to the income statement as the income of the relevant years. As such, a false reserve had emerged by the name Ministry Reserve by that value.

(b) Payment of voluntary pension compensation, gratuity and outstanding provident funds of the employees of the Corporation had been made by the State Resources Management Corporation. The sum totalling Rs.387,275,583 paid therefor to the Corporation by the said corporation from the year 2012 up to the year 2016 in two instances had been brought to account as Treasury loans under long term liabilities instead of showing as payable to the State Resources Management Corporation.

(c) A sum totalling Rs.26,067,612 that should be included under the establishments and administrative expenditure of the Corporation and a sum totalling Rs.1,222,500 paid to the Top Management as allowances had been brought to account as production expenditure in the financial statements.

(d) Direct expenditure on production of tiles totalling Rs.1,552,909 that should be included in the production cost had been brought to account as establishments and administrative expenditure.

(e) Accrued rent totalling Rs.566,810 relating to 10 months from March to December in the year 2016 had not been brought to account.

(f) Five Imprest Accounts had been maintained by the Head Office of the Corporation during the year for each factory and financial statements had been prepared without settling the imprest accounts totalling Rs.589,746 as at 31 December 2016 relating to 05 factories.

2.2.5 Unexplained Differences

The following observations are made.

(a) According to the Report on Physical Verification of Stocks as at 31 December 2016, a sum of Rs.3,058,645 and a sum of Rs.1,186,269 had been debited and credited to the Profit and Loss Account respectively through Journal Entry No. 12/58 to tally the total stock balance amounting to Rs.43,430,594 with the stock balance of the Ledger. No adequate explanations had been made available to Audit in respect of this accounting, carried out without identifying the deficit and surplus of the stocks in the year.

(b) Cash in hand amounting to Rs.48,949 at the Head office of the Corporation in the year under review had been credited to the Ledger Account through Journal Entry No.12/108 and debited that amount to the Suspense Account. The accuracy of accounting this Journal Entry had not been explained to Audit. As such, the accuracy of the balance of Rs.125,000 in the Cash in Hand Account as at the end of the year under review could not be confirmed in Audit.

(c) There had been a difference totalling Rs.2,191,248 of the opening balances as at 01 January 2016 in 06 Imprest Accounts used in granting money for incurring expenditure on 05 factories of the Corporation. The Imprest Accounts had been balanced in the year under review by debiting the Suspense Account and crediting the Imprests Account by that amount respectively through Journal Entry Numbers 12/112 and 12/108 without identifying and rectifying the difference. As such, the accuracy of balancing this account had not been explained to Audit.

(d) The Control Accounts had been balanced through Journal Entry No.1/55 by transferring debit balances of Rs.216,049 and Rs.451,000 and a credit balance of Rs.24,000 in the Management Control Accounts of Oddusudan, Eragama and Elayapaththuwa Factories respectively in the year under review. Accordingly, adequate evidence had not been made available to Audit in confirmation of the accuracy of the Management Control Accounts.

2.2.6 Lack of Evidence for Audit

Due to lack of evidence indicated against the following items of accounts, they could not be satisfactorily vouched or accepted in audit.

	Item	**Value** **Rs.**	**Evidence not made available**
(a)	Lands and Buildings	23,755,784	Title Deeds, Licenses or other legal documents to ensure the ownership of the lands of 187 acres 02 roods in extent relating to 07 tile factories of the Corporation.
(b)	Property, plant and equipment of two factories	3,533,383	Reports on Boards of Survey on Fixed Assets
(c)	Payable Tax	176,263,306	Tax files and confirmation letters and documents of computation adequate in confirming the tax liability.
(d)	Income Tax receivable	1,221,666	
(e)	Other deposits	3,010,675	Deposit registers and confirmation of balances

2.3 Accounts Receivable and Payable

The following observations are made.

(a) The trade and other receivable balances totaling Rs.7,547,407 as at the end of the year under review comprised of balances totalling Rs.2,316,853, Rs.539,937 and Rs.1,289,031 from 01 to 02 years, 02 to 03 years and for over 03 years respectively.

(b) The trade and other payable balances totalling Rs.59,466,030 as at the end of the year under review comprised of loan balances totalling Rs.485,025, Rs.157,045 and Rs.36,556,829 from 01 to 02 years, 02 to 03 years and for over 03 years respectively.

(c) Action had not been taken to settle audit fees totalling Rs.1,580,630 shown as payable as at 31 December 2016.

2.4 Non-compliance with Laws, Rules, Regulations and Management Decisions

Instances of non-compliance with laws, rules, regulations etc. observed during the course of audit are as follows.

Reference to Laws, Rules, Regulations, etc.	Non-compliance
(a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka	
(i) Financial Regulation 135	Functions relating to financial control had not been delegated in writing.
(ii) Financial Regulation 384 (3)	A Register for cheque books had not been maintained.
(iii) Financial Regulation 386 (6)	All cheques must be made payable to order and be crossed and in opening cheques for transactions, the crossing should be cancelled by an endorsement on the body of the cheque. However, payments totalling Rs.1,825,000 had been made during the year under review using open cheques in 13 instances.
(iv) Financial Regulation 395(h)	The Bank Reconciliation Statement should invariably be prepared by an officer who has no connection with the banking of collection, the writing out of cheques or the maintenance of the cash book. However, all the above purposes had been carried out by one officer.

(b) Public Enterprises Circular No. PED/12 of 02 June 2003 Section 4.2.6	The performance report should be reviewed once in 03 months and submitted to the Department of Public Enterprises and to the Treasury within 30 days after the closure of the quarter. However, action had not been taken accordingly.
(c) Circular No.03/2015 of 14 July 2015 of the Ministry of Finance	Even though advances obtained should be settled immediately after completing the purpose for which it was granted for, action had not been taken as at the end of the year under review to settle advances totalling Rs.326,903.
(d) Public Enterprises Circular No.PED1/2015 of 25 May 2015 Sections 3.2 and 3.2.2	In providing additional fuel to officers who are entitled to the fuel allowance, the approval of the Secretary to the line Ministry should be obtained. Nevertheless, payments had been made for additional fuel valued at Rs.166,955 in 15 instances during a sample test period of 06 months in the year under review without obtaining such approval.
(e) Treasury Circular No.842 of 19 December 1978	A Register of Fixed Assets on Lands, Buildings and Motor Vehicles to the total value of Rs.38,884,096 belonging to the Corporation had not been maintained in an updated manner.

2.5 Activities not supported by Adequate Authority

The written approval of the Treasury and the line Ministry had not been obtained for re-opening the closed down tile factories.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Corporation for the year under review had been a net profit of Rs.12,500,267 as compared with the corresponding net profit of Rs.3,585,434 of the preceding year, thus indicating an improvement of Rs.8,914,833 in the financial result of the year under review as compared with the preceding year. The sum of

Rs.63,379,054 received from the Treasury in the year 2015 for recurrent expenditure had not been received in the year 2016. However, the increase in sales by Rs.60,147,061 and other income by Rs.3,631,958 and the decrease in establishment and administrative expenditure by Rs.49,893,646 had mainly attributed to the above improvement.

An analysis of the financial results for the year under review and 04 preceding years revealed a loss in the year 2014 and net profits in the years 2012, 2013, 2015 and 2016. However, in readjusting the employees' remuneration, Government tax and depreciation for non-current assets to the financial result, the contribution of the Corporation which was Rs.70,430,185 in the year 2012 had decreased to Rs.35,980,387 and Rs.10,978,743 by the end of the years 2013 and 2014 respectively. Nevertheless, the contribution had increased again since the year 2015 and it had been Rs.75,889,133 by the end of the year 2016.

3.2 Analytical Financial Review

The following observations are made.

(a) The current ratio and the instant ratio of the Corporation were 0.34 and 0.12 respectively in the year 2015 and they had been 0.42 and 0.21 respectively in the year 2016. As these liquidity ratios had existed at a very low level, the liquidity of the Corporation had been at a weak level.

(b) The Gross Profit Ratio of the Corporation which was 3.07 per cent in the year 2015 had increased up to 14.65 per cent by the year 2016 representing 377 per cent. The net profit ratio which was 4.15 per cent in the year 2015 had increased up to 8.54 per cent by the year 2016 representing 248 per cent. The rapid increase in sales value over the increase of the sales cost, increase in other income by 145 per cent and the decrease in establishment and administrative expenditure by 77 per cent had attributed to this improvement.

4. Operating Review

4.1 Performance

According to the Gazette Extraordinary of the Government of Ceylon of 01 August 1958, the main objective of the Corporation is to be the pioneer in the market by producing various standard types of tiles, bricks and clay related productions and supply of materials to satisfy all types of customers under competitive quotations and bear a social responsibility thereon.

The following observations are made in achieving the above objectives.

(a) According to a Decision of the Cabinet of Ministers on restructuring the Corporation with the main objective of leasing out the 09 factories belonging to the Corporation to private investors on long term basis, a Competent Authority had been appointed from 01 July 2010 after removing the Chairman and the Board of Directors. Accordingly, employees had been made to retire on voluntary pensions scheme from 31 March in the year 2012 as Phase 1 of the process on leasing out factories. However, according to instructions on restructure, action had not been taken to lease out any of the factories up to December 2017 and 05 factories had been operated by recruiting employees on contract and daily basis.

(b) Out of 09 Factories belonging to the Corporation, 04 Factories had been closed down on various reasons. Only the two Factories at Eragama and Uswewa had earned profits of Rs.34,836,777 and Rs.5,936,366 respectively in the year 2016 and the total loss of the other three factories was Rs.14,296,235.

(c) The loss of the two Factories at Bingiriya and Mahiyanganaya had decreased in the year 2016 as compared with the year 2015 while the profit of the Eragama Factory had increased. The Uswewa Factory which had sustained losses in the year 2015 had earned a profit of Rs.5,936,366 in the year 2016 while only the loss of the Yatiyana Factory had increased by Rs.2,599,853.

(d) There had been 3,112,050 production units in the Corporation in the year 2012 and in relation to that, an annual decrease in the production was observed in the years 2013 and 2014. In the year 2015, the production had again increased up to 2,609,256 units while in the year 2016 it had increased up to 3,950,914. Accordingly, the production in the year 2016 had increased by 20.6 per cent and 51.4 per cent respectively as compared with the years 2014 and 2015.

(e) The income from sale of production of the Corporation was Rs.112,655,859 in the year 2012 and it had declined to Rs.77,920,760 by the year 2013 representing 30.8 per cent. The income from sales had increased annually from the year 2014 and in the year 2016 it had been Rs.156,682,174. Accordingly, the income from sales in the year 2016 had increased by 84.6 per cent as compared with the year 2015.

(f) According to the performance reports of the year under review, the progress achieved on each objective mentioned in the Action Plan had not been mentioned. As such, the progress in achievement of each objective and target mentioned in the Action Plan, could not be examined.

4.2 Management Activities

The following observations are made.

(a) An interest free temporary loan of Rs.5,000,000 had been provided in the year 2012 to the Janatha Estates Development Board on the basis of recovery in 90 days and action had not been taken to recover that loan even as at 31 December 2016.

(b) The approval of the present line Minister and the Director General of Public Enterprises of the Treasury had not been obtained for the Competent Authority appointed in the year 2015.

4.3 Operating Activities

Even though a sum totalling Rs.23,372,090 had been brought to account as the Fixed Assets Replacement Reserve since the year 2009 by the Corporation, no financial investment had been made for replacement of relevant assets.

4.4 Transactions of Contentious Nature

A sum totalling Rs.214,433 had been spent for producing 10,880 tiles during the period from September to October 2016 with the brand name (DSI) of a private company by the Uswewa Tile Factory during the year under review. Out of those produced tiles, 6,492 tiles had been in saleable condition. However, according to matters mentioned from clauses 10 to 13 of the Memorandum of Understanding of the private company with the brand name DSI, action had not been taken to purchase those tiles.

4.5 Uneconomic Transactions

The following observations are made.

(a) Action had not been taken to make payments within the due period after properly computing the gratuity payments in accordance with the Gratuity Payment Act, No.12 of 1983. As such, a surcharge of Rs.141,446 had to be paid in the year under review.

(b) In terms of the judgement of a case filed at the Labour Tribunals by two employees against unfair termination of employment, the Corporation had paid compensations totalling Rs.1,081,800 ordered by the Labour Tribunals to be paid to those employees in the year under review.

4.6 Staff Administration

The following observations are made.

(a) In terms of Section 9.2 of Public Enterprises Circular No. PED/12 of 02 June 2003, the approval of the Department of Public Enterprises should be obtained in respect of the approved cadre. However, action had not been taken to obtain approval for the staff necessary for carrying out future activities of the Corporation after paying compensation and removing the employees under the restructuring of the Corporation in the year 2012.

(b) In terms of Section 9.10 of the aforesaid Circular, the approval of the Secretary to the Treasury should be obtained in the recruitment of employees on contract, casual or other basis. However, 61 officers had been recruited on contract basis without obtaining such approval.

(c) A total of Rs.330,000 comprising totals of Rs.50,000 and Rs.280,000 had been paid in the years 2016 and 2017 respectively by the Corporation to an employee recruited for the Ministerial staff of the Ministry of Public Enterprise Development on full time basis.

(d) A Finance Manager had been recruited in November 2015 without approving the Schemes of Recruitment and Promotion and without following a proper scheme of recruitment and salaries and allowances totalling Rs.675,000 had been paid in the year under review. The service of that officer had been terminated in January 2017.

5. Accountability and Good Governance

5.1 Non-presentation of Financial Statements

In terms of Section 6.5.1 of Public Enterprises Circular No. PED/12 of 02 June 2003, the financial statements and the Draft Annual Report should be presented to the Auditor General within 60 days after the closure of the financial year. However, the financial statements for the year 2016 had been presented to Audit on 22 December 2017.

5.2 Corporate Plan

In terms of Section 5.1 of Public Enterprises Circular No. PED/12 of 02 June 2003, a Corporate Plan had not been prepared by the Corporation.

5.3 Action Plan

The following observations are made.

(a) In terms of Section 5.1.2 of Public Enterprises Circular No. PED/12 of 02 June 2003, the responsibility of the Managers of the Corporation towards the objectives and targets mentioned in the Action Plan should be clearly indicated. Nevertheless, the Corporation had failed to act accordingly.

(b) In terms of Section 5(2) of Public Finance Circular No.01/2014 of 14 February 2014, the commercial activities intended to be implemented in the ensuing financial year based on the business plan prepared by the Corporation, had not been included in the Action Plan.

5.4 Audit Committee

In terms of Section 7.4.1 of Public Enterprises Circular No. PED/12 of 02 June 2003, audit committee should be held at least once in three months. Nevertheless, the Corporation had held only one audit committee during the year under review.

5.5 Procurement Plan

In terms of Guideline 4.2 of the Government Procurement Guidelines No.08 of 25 January 2006, a Procurement Plan had not been prepared for the year under review by the Corporation.

5.6 Budgetary Control

In terms of Section 8(1) of the Finance Act No.38 of 1971 and Section 5.2 of Public Enterprises Circular No. PED/12 of 02 June 2003, a budget had not been prepared by the Corporation for the year under review.

5.7 Tabling of Annual Reports

In terms of Section 6.5.3 of Public Enterprises Circular No. PED/12 of 02 June 2003, the annual reports should be tabled in Parliament in three languages within 150 days after the closure of the financial year. Nevertheless, the annual reports from the year 2010 to the year 2015 had not been tabled in Parliament up to December 2017.

6. Systems and Controls

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Competent Authority of the Corporation from time to time. Special attention is needed in respect of the following areas of control.

Areas of Systems and Controls	Observations
(a) Financial Control	(i) Failure in maintaining Books of Accounting including the Ledger in an updated manner. (ii) Non-employment of an officer of the permanent staff for the purposes of the Accounts Section. (iii) Proper non-maintenance of a process on accounting advances and non-maintenance of a Register of Advances. (iv) Non-implementation of a proper system of internal control in the Corporation.
(b) Stores Control	(i) Failure in physical verification of non-current assets (ii) Non-completion of the physical stock taking during a short period.
(c) Operating Control	Non-implementation of the process of leasing out factories.